DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 97-0521SLOF
Indiana Adjusted Gross Income Tax
For the Years 1993, 1994, and 1995

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ISSUE

I. Reallocation of Taxpayer's Sales to Indiana – Throw-back Sales.

Authority: 15 U.S.C.S. § 381; IC 6-3-2-2(e); IC 6-3-2-2(n); IC 6-3-2-2(n)(1); IC 6-3-2-2(n)(2); Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992). Indiana Dept. of State Revenue v. Continental Steel Corp., 399 N.E.2d 754 (Ind. Ct. App. 1980); 45 IAC 3.1-1-53(5); 45 IAC 3.1-1-64.

Taxpayer argues that income it received from selling its products within other states should not be thrown back to Indiana because taxpayer's out-of-state activities were sufficient to establish nexus with those foreign states.

STATEMENT OF FACTS

Taxpayer is in the business of producing custom-designed plastic products. Most of its business is generated by the design, manufacture, and sale of custom designed packing and shipping trays which taxpayer refers to as "Transport Packaging Systems." Taxpayer's customers include television picture tube manufacturers and automobile component manufacturers. Taxpayer ships products from its plants in Indiana to other states.

Taxpayer original protest was addressed within a Letter of Findings (LOF) which concluded that "taxpayer's protest is sustained subject to the findings of a supplemental audit" because the LOF determined that the taxpayer had presented evidence of an "ongoing, complex, collaborative" endeavor between itself and its out-of-state customers.

That supplemental audit was conducted and concluded that the "taxpayer did not produce evidence to establish that the activities of the taxpayer created nexus in each state during the audit period." Therefore, the supplemental audit "[was] unable to make supplemental audit adjustments to the billing."

The taxpayer requested and was granted an opportunity for a rehearing. That rehearing was held, and this Supplemental Letter of Findings followed.

DISCUSSION

I. Reallocation of Taxpayer's Sales to Indiana – Throw-back Sales.

Taxpayer protested the imposition of the Indiana adjusted gross income tax on sales income received from certain out-of-state customers. The original audit had determined that, for purposes of determining the taxpayer's adjusted gross income, sales to out-of-state customers should be allocated back to Indiana because the sales were made to customers located within states in which the taxpayer was not subject to an income tax. Under 45 IAC 3.1-1-53(5) "[I]f the taxpayer is not taxable in the state of the purchaser, the sale is attributed to [Indiana] if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state." Such sales are designated as "throw-back" sales. Id.

Taxpayer does business in 39 states outside of Indiana. With the exception of Idaho and Alaska, taxpayer argues that it is entitled to a blanket exemption from the application of Indiana's throw-back rule because of the intensive, ongoing, and complex relationship it develops with the out-of-state customers when it designs, manufacturers, and sells its Transport Packaging Systems.

Taxpayer believes it is entitled to this blanket exemption under the terms of IC 6-3-2-2 and Public Law 86-272. IC 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if . . . (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and . . . (B) the taxpayer is not taxable in the state of the purchaser." IC 6-3-2-2(n) provides that "[f]or purposes of allocation and apportionment of income . . . a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly allocate income to a foreign state, taxpayer must show that one of the taxes listed in IC 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of whether the state actually does so.

15 U.S.C.S. § 381 (Public Law 86-272) controls the circumstances under which a state may impose a tax on the income – derived from sources within that state – by an out-of-state taxpayer. 15 U.S.C.S. § 381 establishes the minimum standard for the imposition of a state income tax based on the solicitation of interstate sales. Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447, 2453 (1992). 15 U.S.C.S. § 381 prohibits a state from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within the taxing state unless those business activities exceed the mere solicitation of sales. 15 U.S.C.S. §

381(a), (c). Conversely, the effect of the throw-back rule is to revert sales receipts back to the state from where the goods were originally shipped in those situations where 15 U.S.C.S. § 381 deprives the purchaser's home state of the power to impose a net income tax. 45 IAC 3.1-1-64.

Taxpayer has presented information detailing its representatives' activities in various states. In addition, taxpayer has provided affidavits from certain of its employees describing the number and nature of the contacts between taxpayer and its out-of-state customers. Taxpayer maintains that – because of the extensive contacts it develops with its customers – it is not primarily in the business of selling tangible personal property; it is in the business of providing a service to its customers.

Even accepting taxpayer's basic contention – that it works closely with its out-of-state customers to custom design Transport Packaging Systems – the income here at issue was derived from the sale of taxpayer's unique packaging materials. Taxpayer is not entitled to the blanket exemption from Indiana's throw-back rule because its representatives' activities – even considering that close collaboration with the out-of-state customers – are simply "generally accepted or customary acts in the industry which lead to the placing or orders." Indiana Dept. of State Revenue v. Continental Steel Corp., 399 N.E.2d 754, 759 (Ind. Ct. App. 1980). Taxpayer's representatives clearly provide assistance to past purchaser's of its products; nonetheless, that assistance is provided with the principal aim of obtaining future orders from those same customers.

The statute precludes Indiana from employing the throw-back rule on a taxpayer's out-of-state income when the foreign state "has jurisdiction to subject the taxpayer to a net income regardless of whether, in fact, the state does or does not." IC 6-3-2-2(n)(2). Although not *determinative*, taxpayer's failure to demonstrate that it is already paying a foreign state's income tax on the subject income is clearly *probative* in determining whether Indiana may properly impose its own tax on that income.

FINDING

Taxpayer's protest is respectfully denied.

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